



Global Economy Report

June 2014



Global Economy Report

The Global Economy Report is prepared in cooperation by the Macroeconomic Research Division of Banca Aletti and the Global Governance Programme of the Robert Schuman Centre for Advanced Studies of the European University Institute.

The objective of the Report is to provide an analysis of the current and expected macroeconomic and financial conditions at the global level, with also a focus on key economic areas such as Europe, the USA and ASIA.

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Report closed on June 20 2014

EXECUTIVE SUMMARY

- ❖ In June the World Bank published lower growth forecasts for 2014, in line with OECD forecasts. Total income should grow by 3.4%, caused by lower growth in major economies (+1.9%). This reflects a disappointing Q1 due to rough weather and geopolitical conditions, both phenomena now resolved. Emerging markets' growth should be around 4.8%, restrained from some BRICS countries.
- ❖ In this issue we present a special focus on the global economy.

EXECUTIVE SUMMARY

- ❖ In the euro area, qualitative indicators confirm their levels close to several years' highs, though with some problems in France.
- ❖ Our forecast for aggregate income growth for 2014 is at 1.4%, above consensus; for 2015 at 1.8%.
- ❖ Inflation has reached its lowest level since 2009 at 0.5%, but this should be the lower bound. Deflation risk remains definitely modest.
- ❖ European Parliamentary elections highlighted euro-scepticism growth, with 143 MPs out of 751 against the Union. The number of euro-sceptics increased by 55 compared to the previous Assembly. However, overall there should be no major problems.

- ❖ US growth at the beginning of the year was penalised by adverse climate conditions and destocking after the strong accumulation in H2 2013. With Spring we should witness a positive growth payback. Furthermore, the constant decrease in Jobless Claims, the growth in Payrolls, that is returning to its trend and generally positive consumer confidence support expectations for favourable fundamentals. Forecasts: 2.8% for 2014 and 2.9% for 2015.
- ❖ We expect inflation under 2% for most of the forecasting period, thanks to the output gap accumulated during the Great Recession and these four years of weak recovery. For Core CPI we expect a gradual acceleration. Forecasts: Average Headline CPI at 1.4% in 2014 and at 1.8% in 2015, average Core CPI at 1.8% in 2014 and at 2.1% in 2015.

EXECUTIVE SUMMARY

- ❖ In China the economic slowdown is significant but under control, an effect of the growth re-balancing sought by policy-makers.
- ❖ In Japan, volatility due to higher value added tax, around a persistent growth trend.



EXECUTIVE SUMMARY

	2009	2010	2011	2012	2013E	2014E	2015E
GDP (%YOY)							
US	-3.1	2.4	1.8	2.8	1.9	2.2	2.9
EUROZONE	-4.4	2.0	1.4	-0.6	-0.4	1.1	1.8
GERMANY	-5.1	4.2	3.0	0.7	0.4	2.2	2.1
FRANCE	-3.1	1.7	2.0	0.0	0.2	0.6	1.6
ITALY	-5.5	1.8	0.4	-2.4	-1.8	0.4	1.4
UK	-5.1	1.7	1.1	0.1	1.7	2.7	2.2
JAPAN	-5.5	4.7	-0.6	2.0	1.6	2.1	1.7
BRASIL	-0.3	7.6	2.8	1.0	2.3	1.8	2.0
RUSSIA	-7.8	4.3	4.3	3.4	1.3	0.8	1.8
INDIA	6.4	8.9	7.5	5.1	4.6	4.7	5.4
CHINA	9.2	10.4	9.3	7.7	7.7	7.3	7.2
AUSTRALIA	1.4	2.6	1.4	3.6	2.4	2.8	2.9
KOREA	0.3	6.3	3.6	2.0	2.8	3.6	3.8
INFLATION (%YOY)							
US	-0.4	1.6	3.2	2.1	1.5	1.8	1.9
EUROZONE	0.3	1.6	2.7	2.5	1.4	0.8	1.2
GERMANY	0.2	1.2	2.5	2.1	1.6	1.2	1.7
FRANCE	0.1	1.7	2.3	2.2	1.0	1.0	1.2
ITALY	0.8	1.6	2.9	3.3	1.3	0.7	1.2
UK	2.2	3.3	4.5	2.8	2.6	2.0	2.2
JAPAN	-1.3	-0.7	-0.3	0.0	0.4	2.7	1.7
BRASIL	4.9	5.0	6.6	5.4	6.2	6.4	5.9
RUSSIA	11.7	6.9	8.5	5.1	6.8	6.5	5.5
INDIA	10.8	12.1	8.9	10.4	10.9	9.5	7.8
CHINA	-0.7	3.3	5.4	2.7	2.6	2.5	3.0
AUSTRALIA	1.8	2.9	3.3	1.8	2.4	2.8	2.7
KOREA	2.8	3.0	4.0	2.2	1.3	2.0	2.7

Banca Aletti Forecast

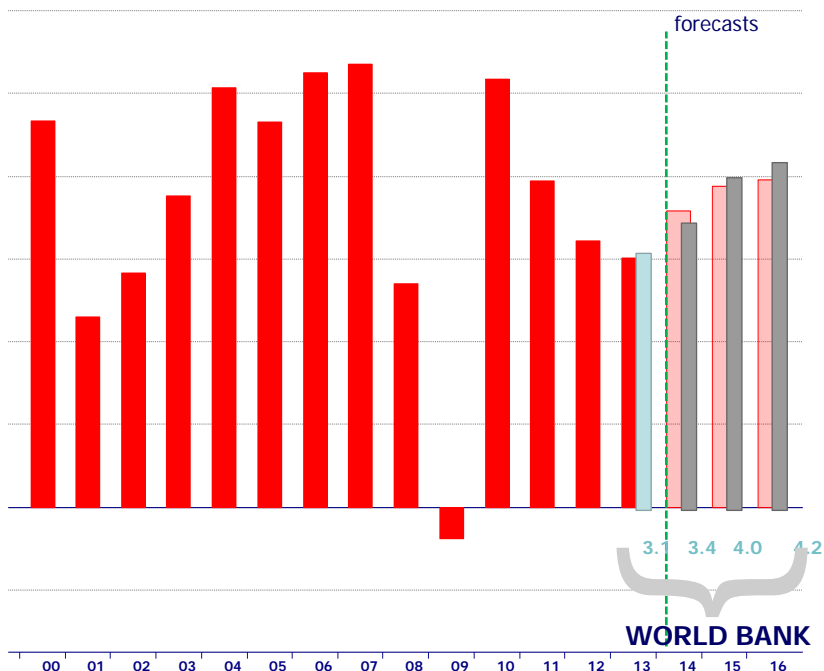
Cons. Bloomberg (Jun 14)

The global economy

Global growth forecasts published in June by the World Bank feature lower growth rates this year than the IMF April forecasts. The revision in growth estimates is basically due to adverse climate conditions that hindered economic activity this winter in the US and political tensions in Eastern Europe, in particular the Ukraine-Russia conflict. The lower estimates for this year at 3.4% (from IMF's 3.6%) are tied to higher growth rates in the following two years, with growth at 4.0% (from 3.9%) in 2015 and 4.2% (from 4.0%) in 2016.

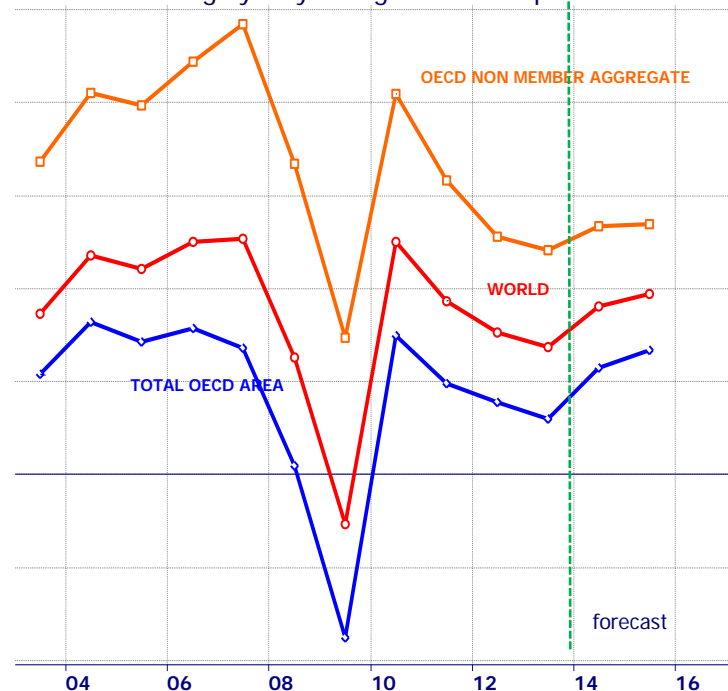
IMF & WB - GLOBAL ECONOMIC GROWTH

Average yearly changes– at fixed prices



IMF - GLOBAL ECONOMIC GROWTH

Average yearly changes– at fixed prices

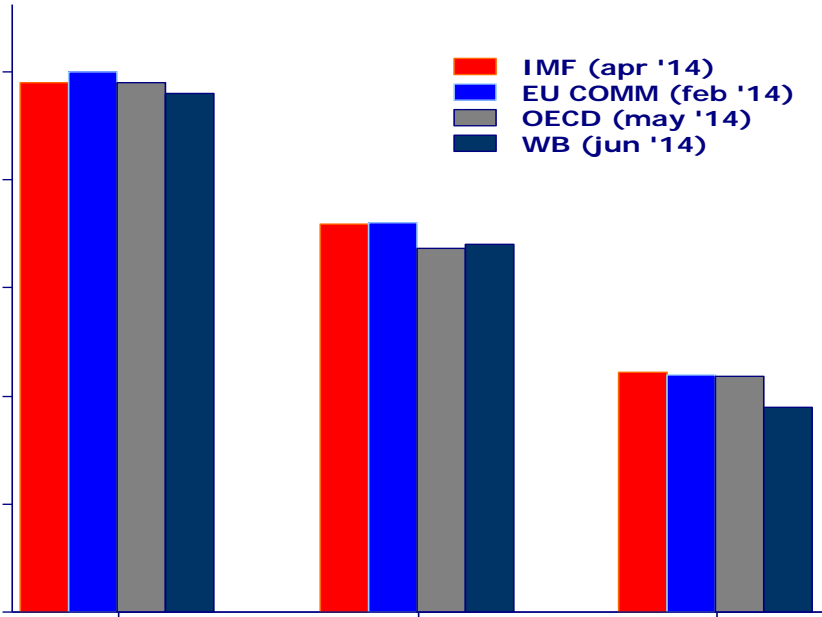


Compared to OECD's global growth forecasts that are the same for 2014 (3.4%), the World Bank estimates a lower increase for both emerging markets at 4.8% (4.9% OECD) and for major economies at 1.9% (2.2% OECD). The greater difference is on this last figure that reflects the cut in US's growth estimate. For 2015 the World Bank foresees a greater increase, with global growth at 4%, driven by emerging economies, with a 5.4% increase, but slowed down by bland growth in major economies that grow by a mere 2.4%.

2014 IMF - EU COMM. – OECD – WB

Average yearly changes– at fixed prices

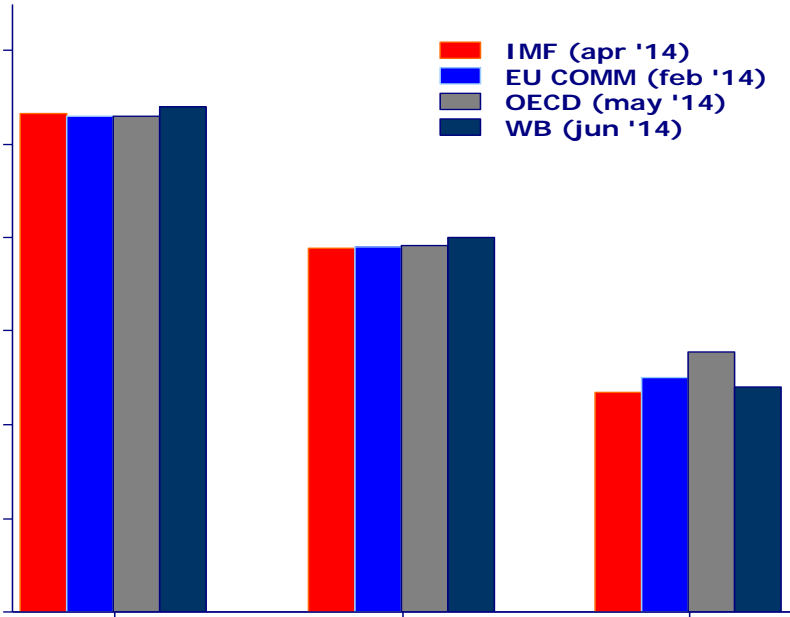
IMF / EU COMM. / OECD / WB



2015 IMF - EU COMM. – OECD - WB

Average yearly changes– at fixed prices

IMF / EU COMM. / OECD / WB



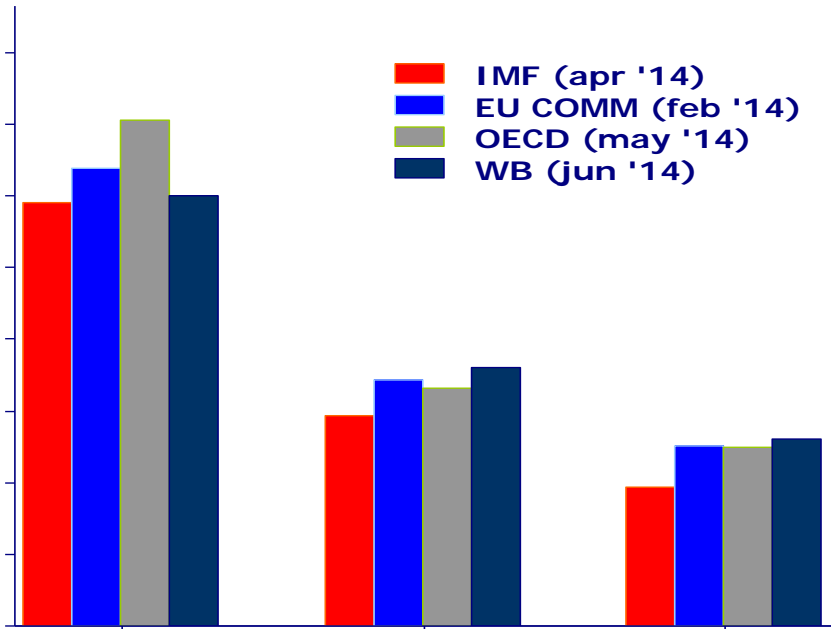
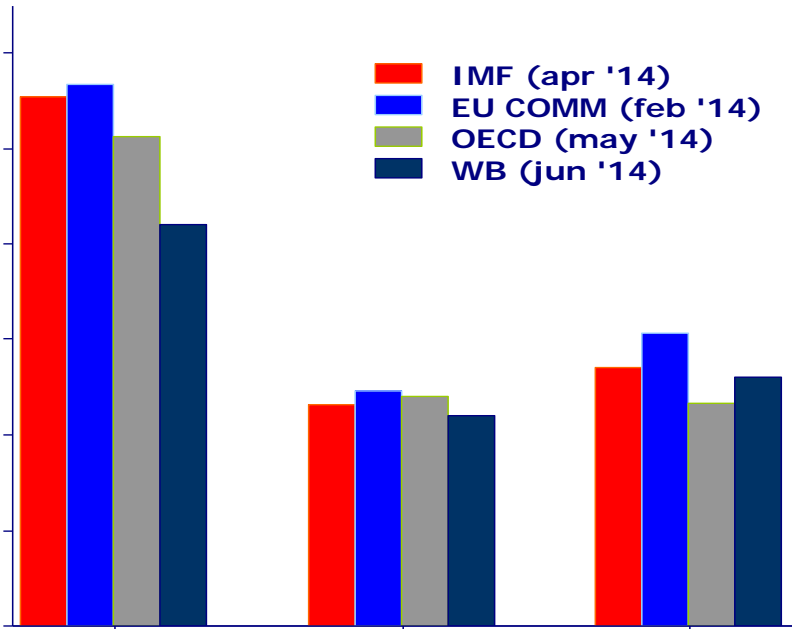
For the current two year period, the major difference among forecasts lies in the US growth forecasts.
 For its calculations, the World Bank used 1Q data, with its unexpected income decrease (-1% on a yearly basis).

2014
IMF - EU COMM. - OECD - WB

Average yearly changes– at fixed prices

2015
IMF - EU COMM. - OECD - WB

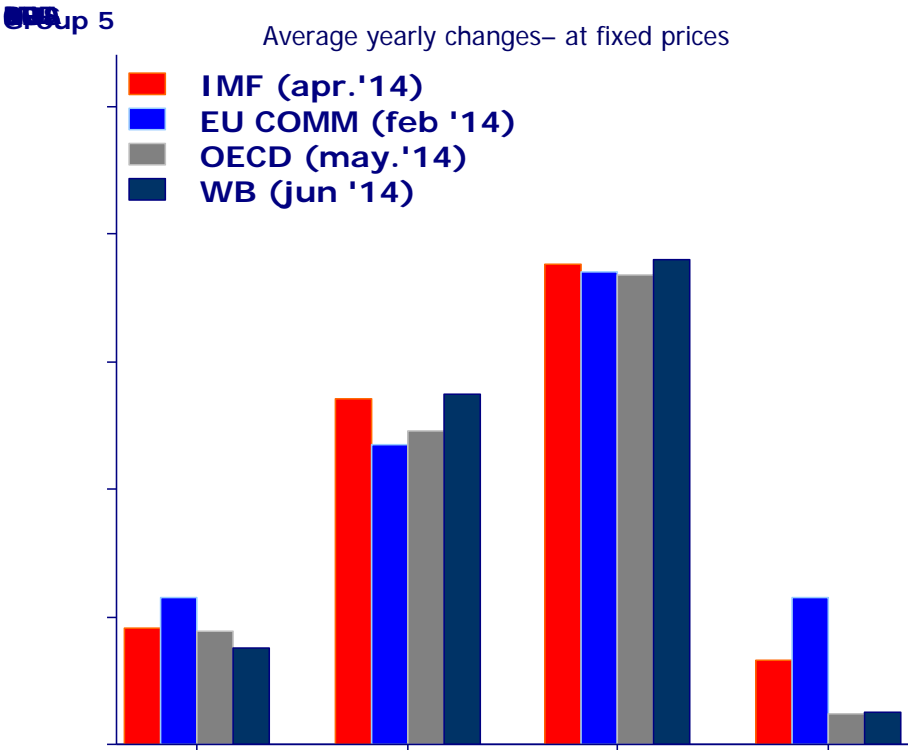
Average yearly changes– at fixed prices



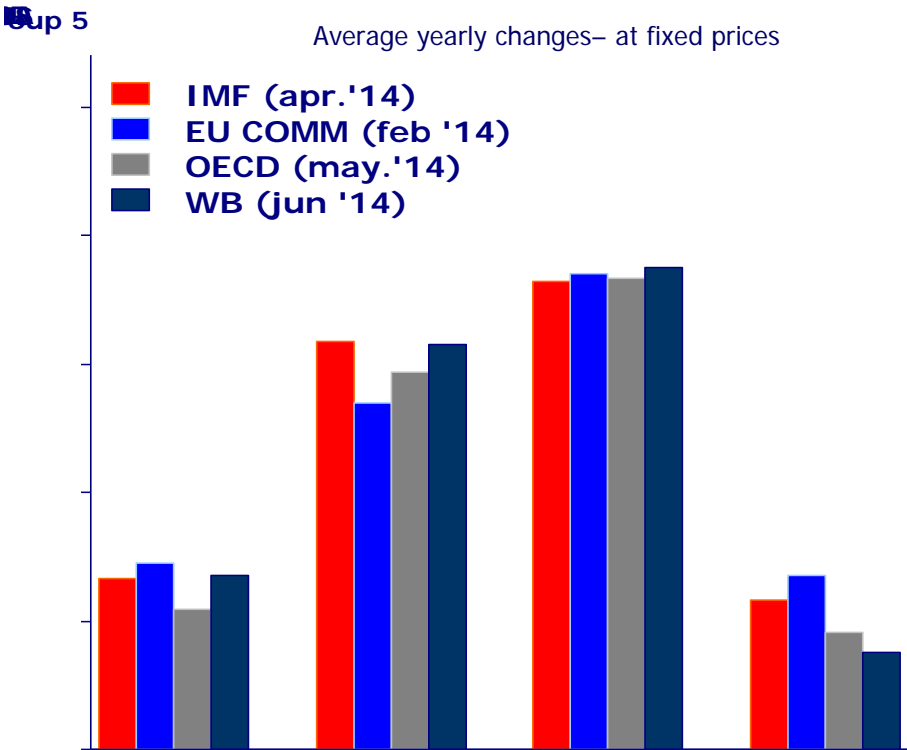
ECONOMIC GROWTH FORECASTS

As for BRIC countries, World Bank's forecasts on China are at 7.6% and 7.5% for these two years; India should grow by 5.5% and 6.3%; in this case estimates have been increased, while for Brazil – 1.5/2.7% - and Russia – 0.5/1.5% - there has been a further cut.

2014 IMF - EU COMM. - OECD



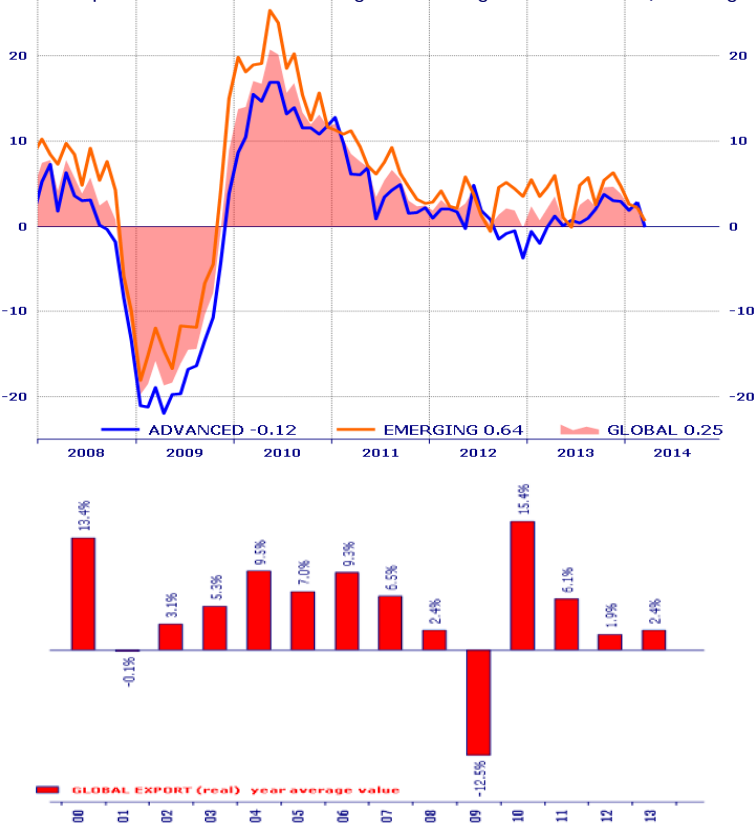
2015 IMF - EU COMM. - OECD



In March international trade data indicate zero increase in volumes traded compared to last year. We assume this dynamic is due to exceptional phenomena such as adverse climate conditions in the US (and Japan), slowdown in Asia due to non proactive Chinese policy and the Russia-Ukraine crisis. Thus, a decrease on a yearly basis among major economies and almost annulment among emerging economies, with a global figure that is practically flat. The leading indicator (Global Manufacturing PMI- new orders) is compatible with a positive trade evolution

INTERNATIONAL TRADE – EXPORT

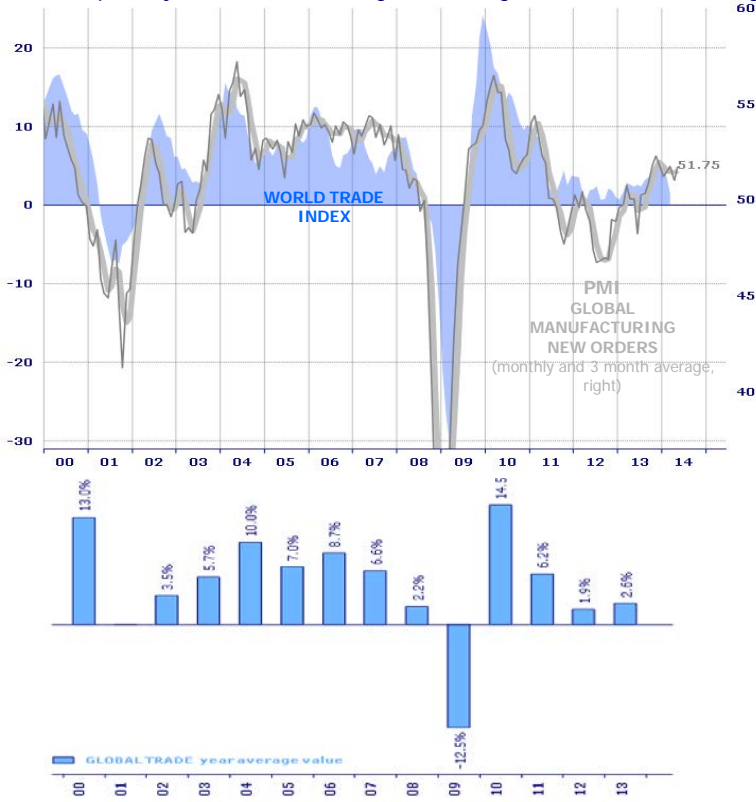
CPB Volume Export index, annualised change and average annual values (bottom graph)



INT. TRADE AND LEADING INDICATOR

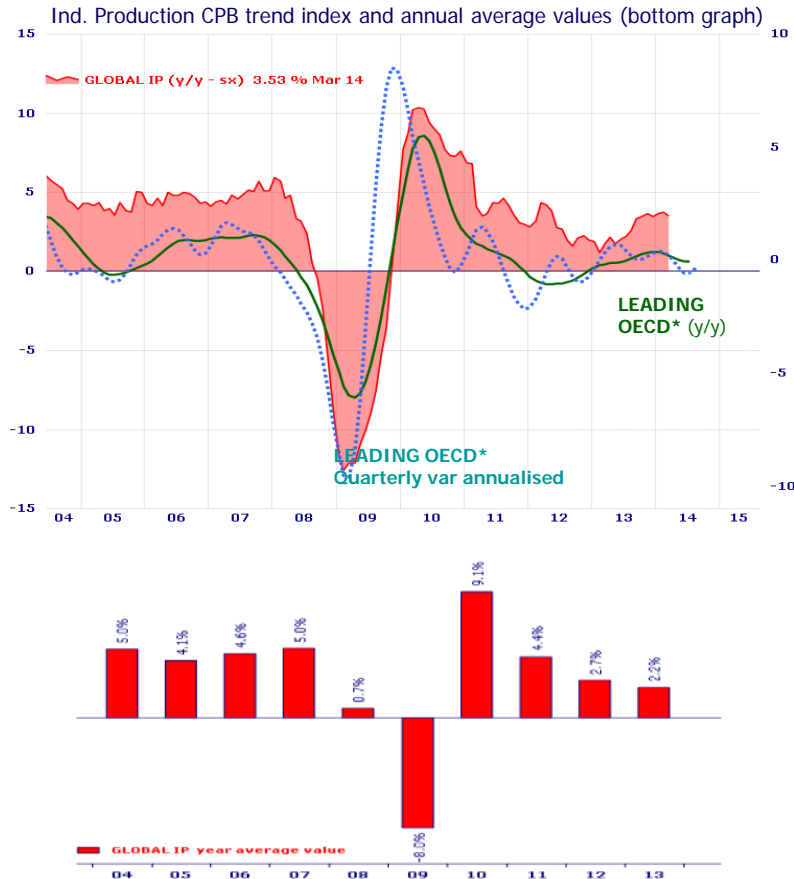
PMI new orders export

World trade quarterly index ann. 6m average and average annual values (bottom graph)



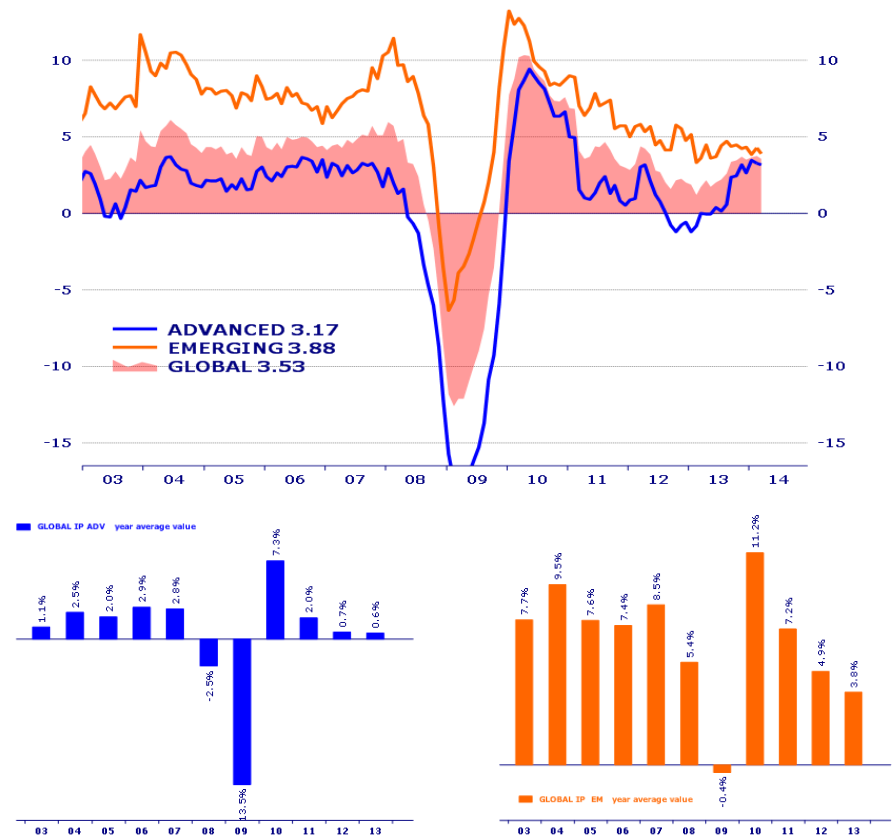
Global industrial activity increased by 3.5% in March, keeping up with levels of a certain intensity. For emerging markets, activity increased under 4.0% on a yearly basis (stable/decreasing), for major economies it grew by 3.2% (stable). Data suggests a reduction in thrust in the short term

GLOBAL IND. PRODUCTION AND LEADING IND.



GLOBAL INDUSTRIAL PRODUCTION

Ind. Production CPB trend index and annual average values (bottom graph)

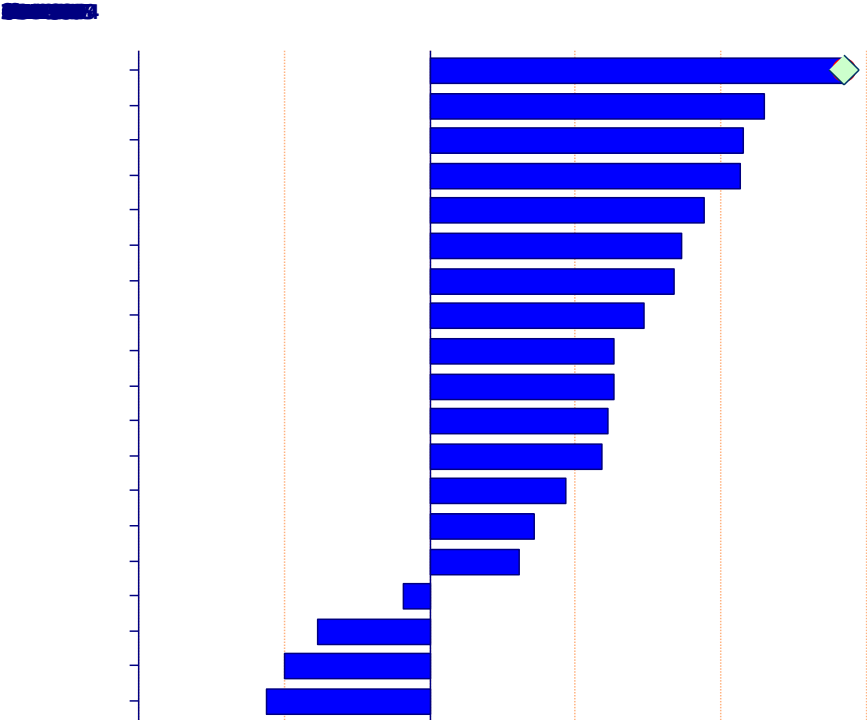


LEADING OECD*: MAJOR ECONOMIES + BRIC + Southafrica + Indonesia

Among major countries for industrial production, activity data signal solid trend values for USA and Japan, positive for UK, Germany and Italy. France and Brazil display contracted conditions. Confidence data signals optimism for British and US businesses, while South Africa, Brazil and Russia still create scepticism.

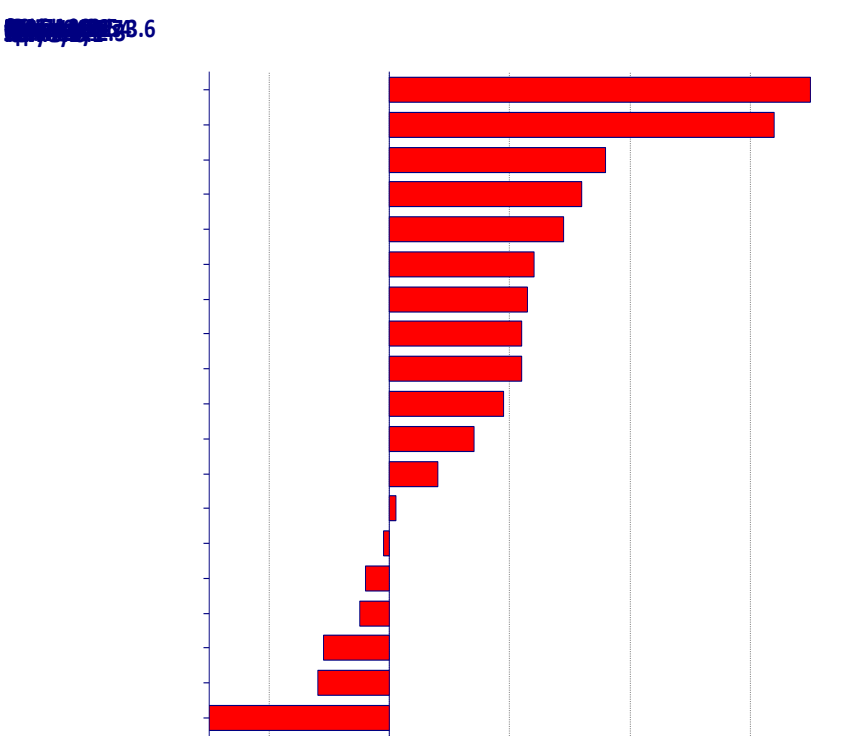
INDUSTRIAL PRODUCTION BY COUNTRY

Industrial production– latest available data – annualised



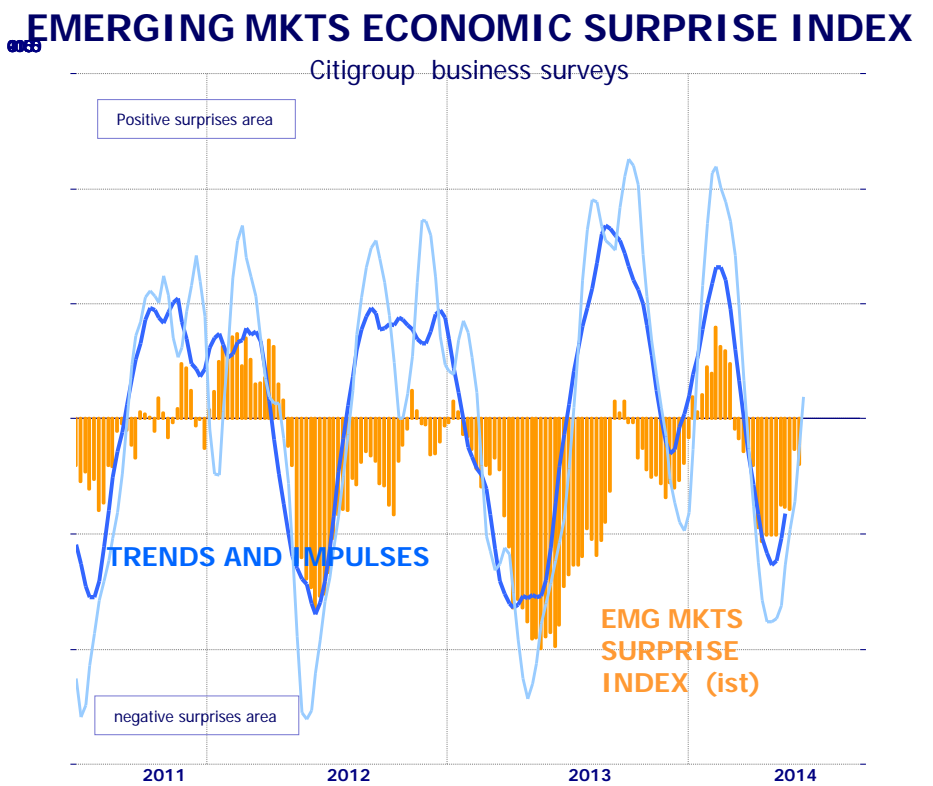
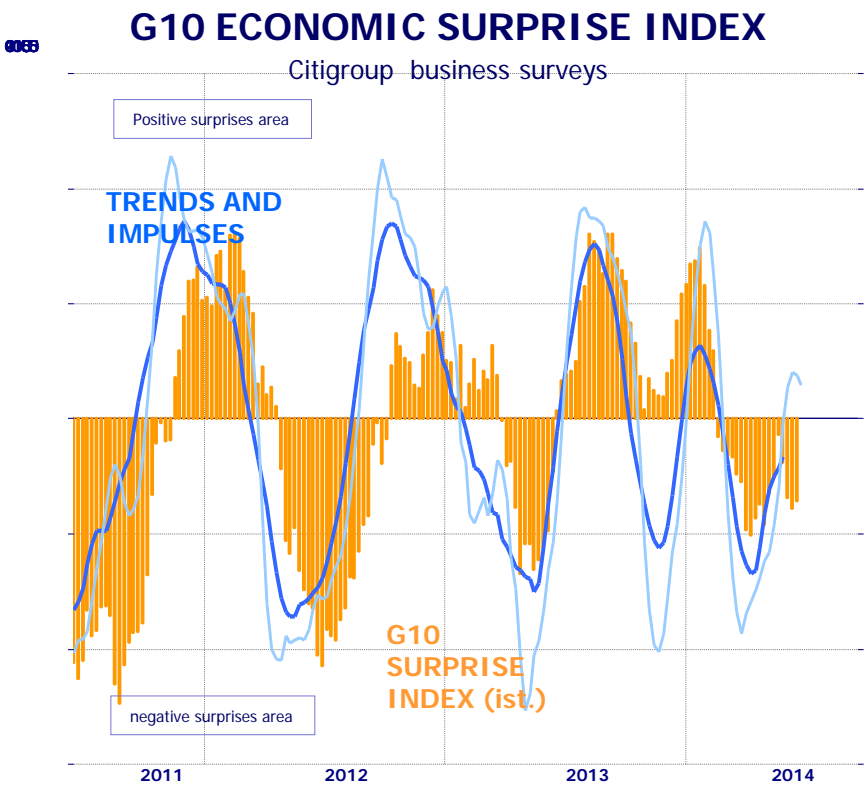
BUSINESS CONFIDENCE BY COUNTRY

Difference between real data and level 50 (stability limit) – Markit PMI, HSBC PMI



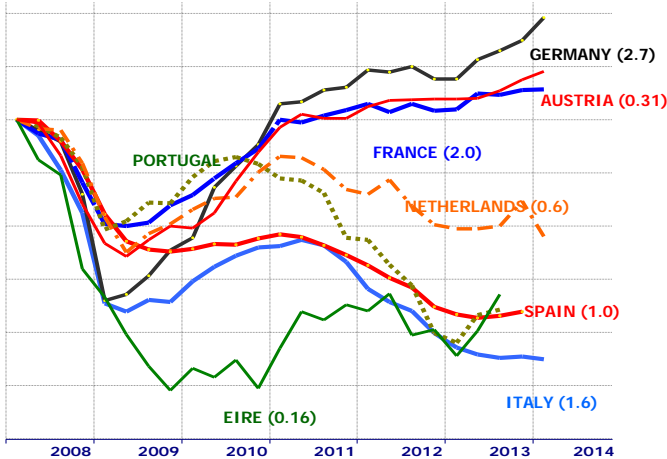
ECONOMIC DATA AND EXPECTATIONS

Analysts' expectations compared to published economic data confirm a majority of negative surprises in major and emerging economies. Dynamic analysis indicates the phenomenon is decreasing everywhere, with the possibility of a favourable evolution in the coming weeks.

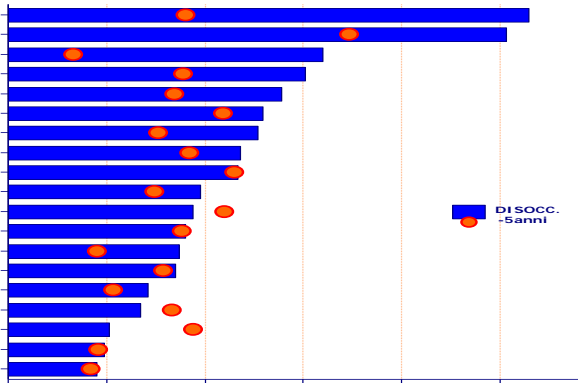


The elections for the European Parliament highlight the growth of euro-scepticism with 143 MPs out of 751. The number of euro-sceptics increased by 55 members compared to the previous Assembly, thanks to frustration of millions of people with the economic crisis that produced business bankruptcies, income drop, destruction of jobs and high unemployment. The net victory in France of Le Pen’s right has triggered a period of political conflict with Hollande’s government. In Italy Renzi’s party’s success certainly strengthened his leadership.

... **EMU – GDP** - Source: Eurostat – fixed prices 2008=100 (bn euro)

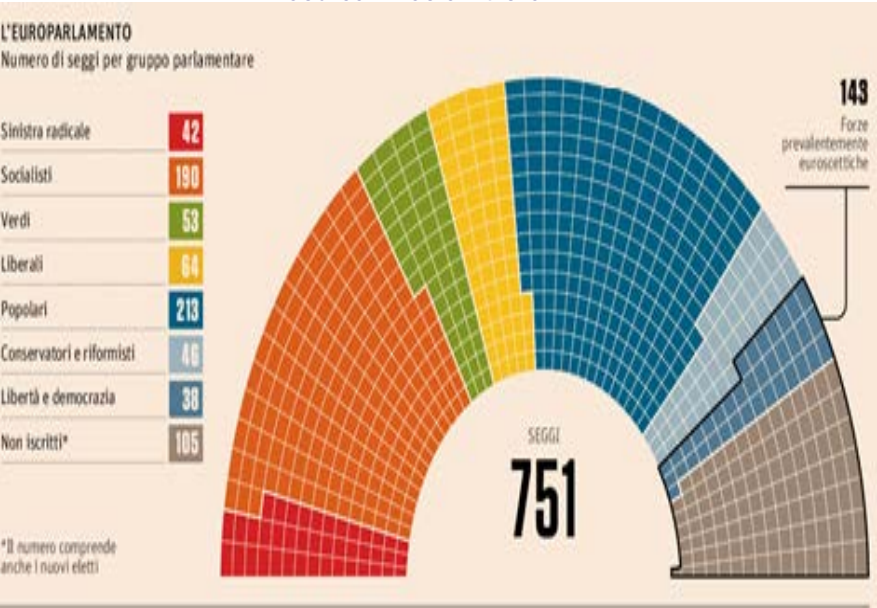


— **UNEMPLOYMENT RATES** - Source: national statistic offices



EUROPEAN ELECTIONS 2014

Source: Il Sole 24 ore

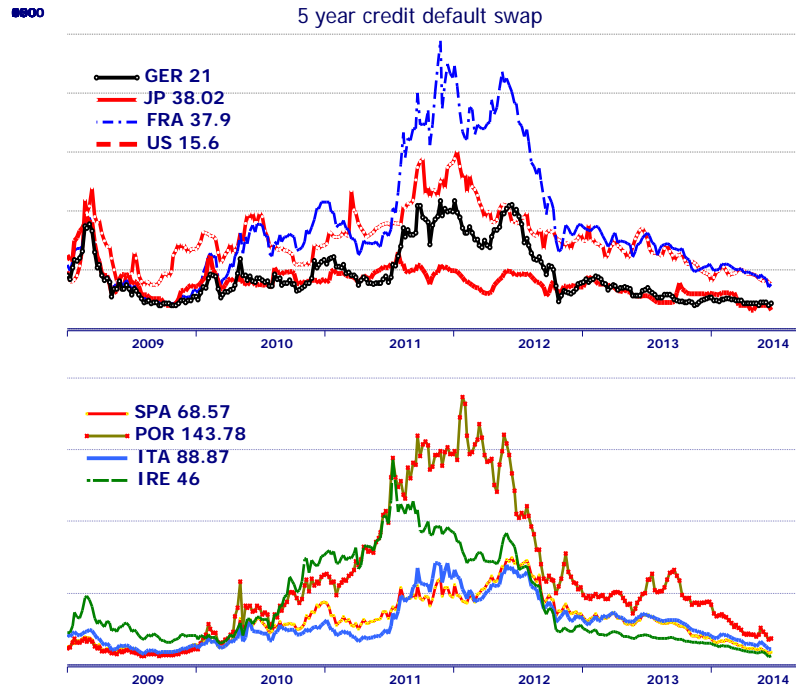


PUBLIC ACCOUNTS AND SOLVENCY

The progressive solution to the Eurozone crisis, the consolidation of public finances in countries in deeper troubles and the improvement of Europe's economic outlook increased rating on several of the Union's countries and on the area as a whole. Greece, Portugal and Spain were upgraded thanks to improved public finances, inverting the trend after months of downgrading.

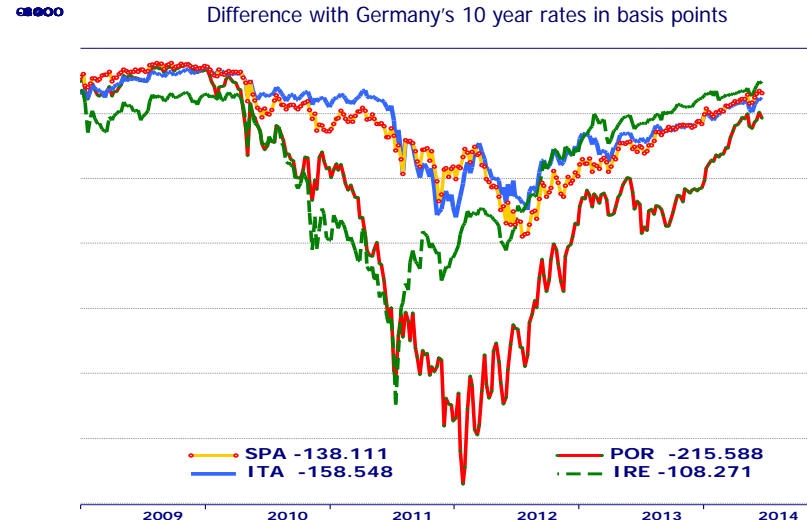
COUNTRY RISK– 5 YEAR CDS

5 year credit default swap



COUNTRY RISK AND RATING

Difference with Germany's 10 year rates in basis points

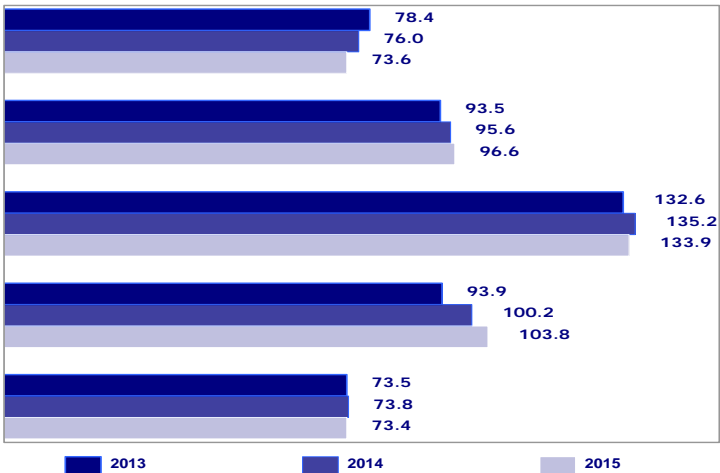


	Moody's	S&P	Fitch
Francia	Aa1	AA	AAA
Germania	Aaa	AAA	AAA
Grecia	Caa3	B-	B
Irlanda	Baa3	BBB+	BBB+
Italia	Baa2	BBB	BBB+
Portogallo	Ba2	BB	BB+
Spagna	Baa2	BBB	BBB+
Giappone	Aa3	AA-	AA-
Stati Uniti	Aaa	AA+	AAA

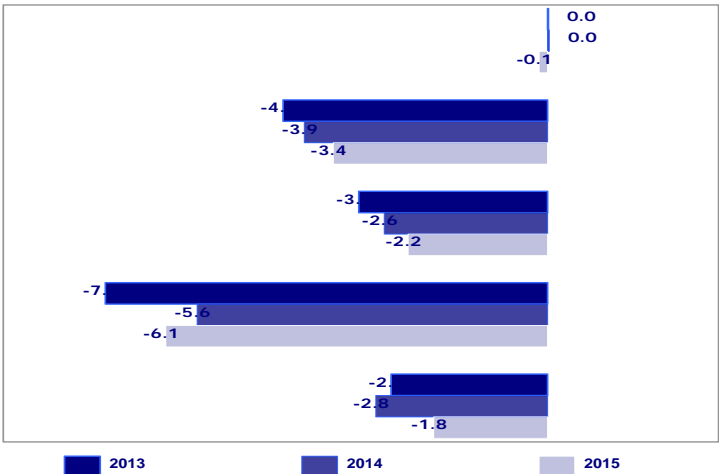
Source: Bloomberg, 16/06/2014

CSDR

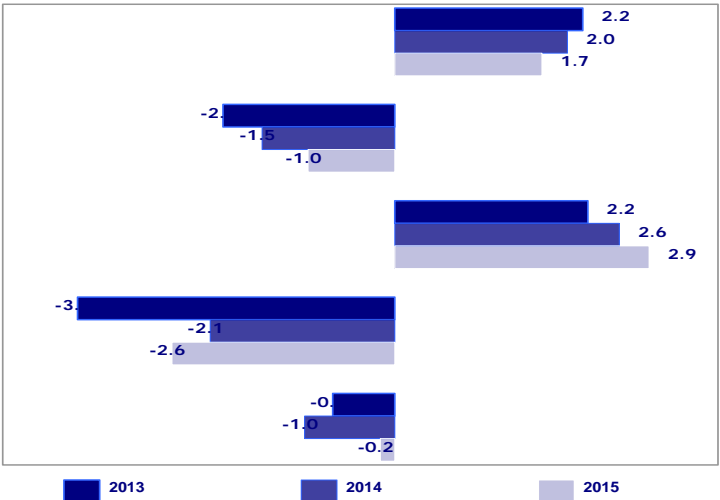
DEBT/GDP estimates 2013-2015



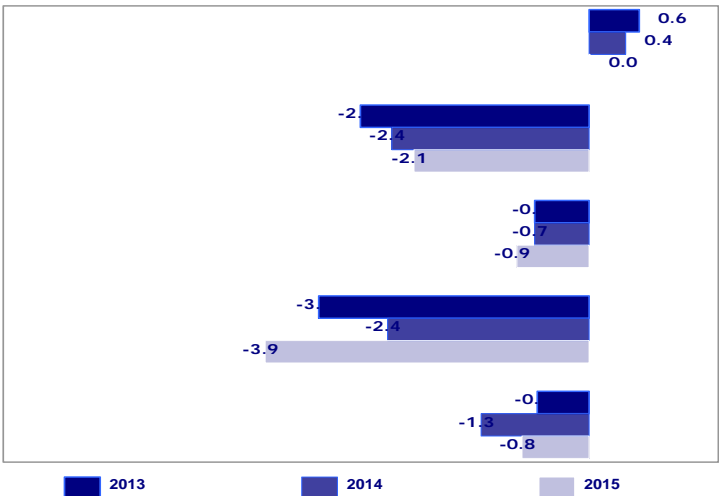
DEBT-SURPLUS/GDP estimates 2013-2015



SURPLUS-PRIMARY DEFICIT/GDP estimates 2013-2015

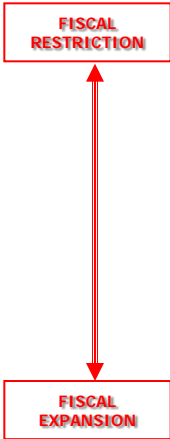
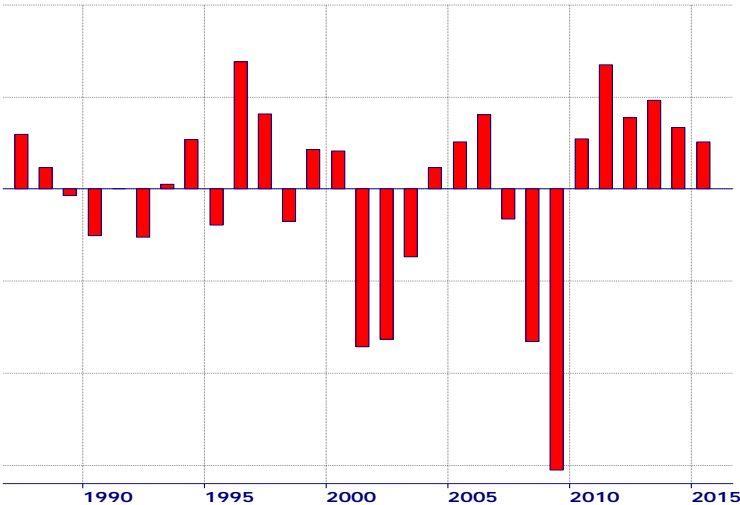


DEBT-SURPLUS/GDP ADJUSTED FOR THE CYCLE



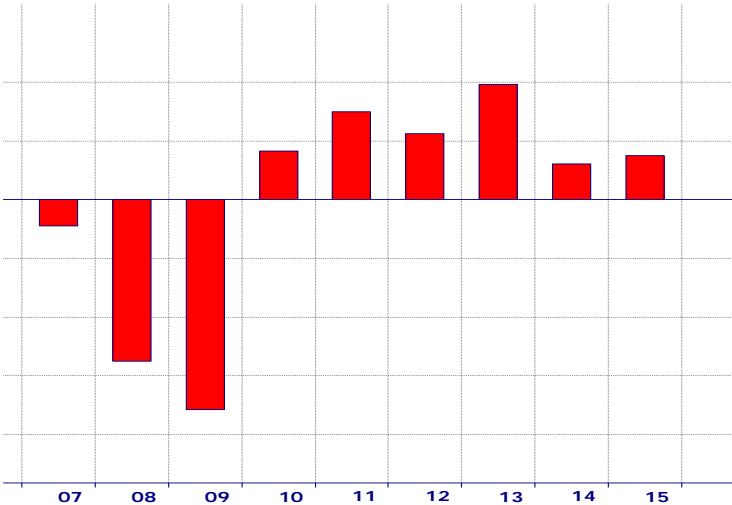
OECD COUNTRIES – PRIMARY BALANCE ADJ. FOR THE CYCLE

OECD data – change % on potential GDP



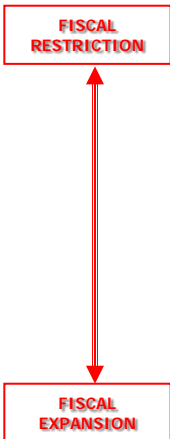
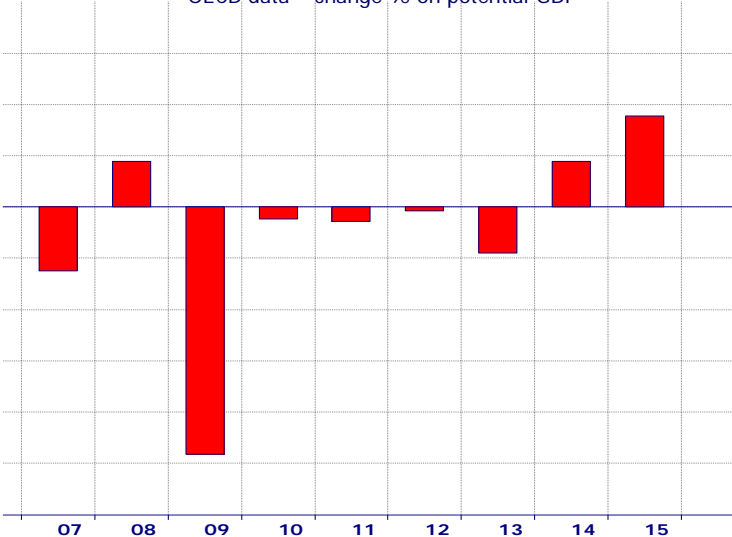
USA – PRIMARY BALANCE ADJ. FOR THE CYCLE

OECD data – change % on potential GDP



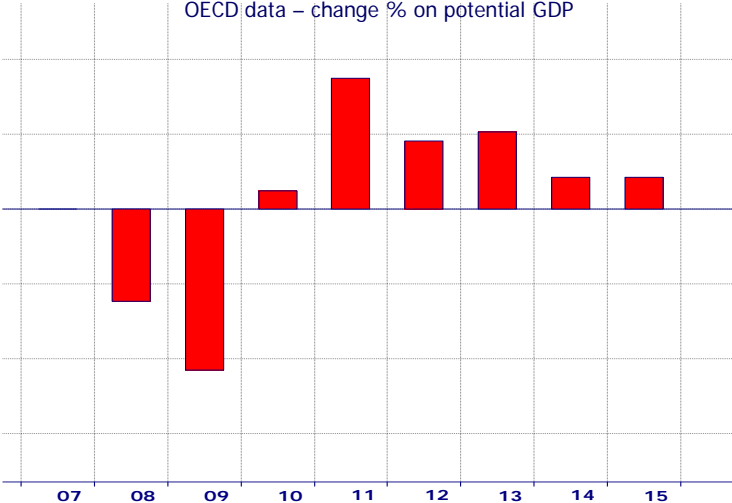
JAPAN– PRIMARY BALANCE ADJ. FOR THE CYCLE

OECD data – change % on potential GDP



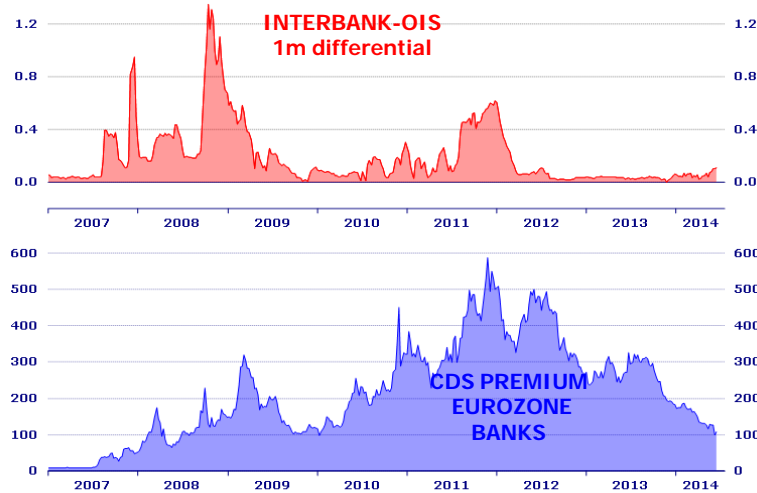
EUROZONE– PRIMARY BALANCE ADJ. FOR THE CYCLE

OECD data – change % on potential GDP

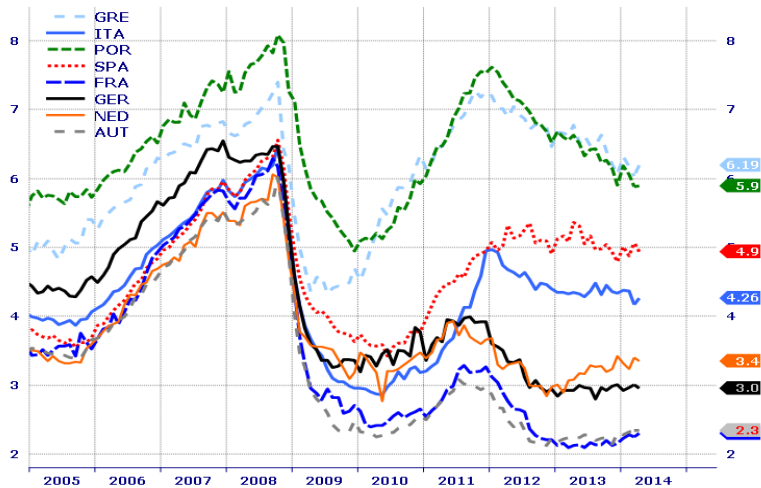


MONETARY POLICY AND FINANCIAL CONDITIONS

OIS SPREAD & CDS €BANKS

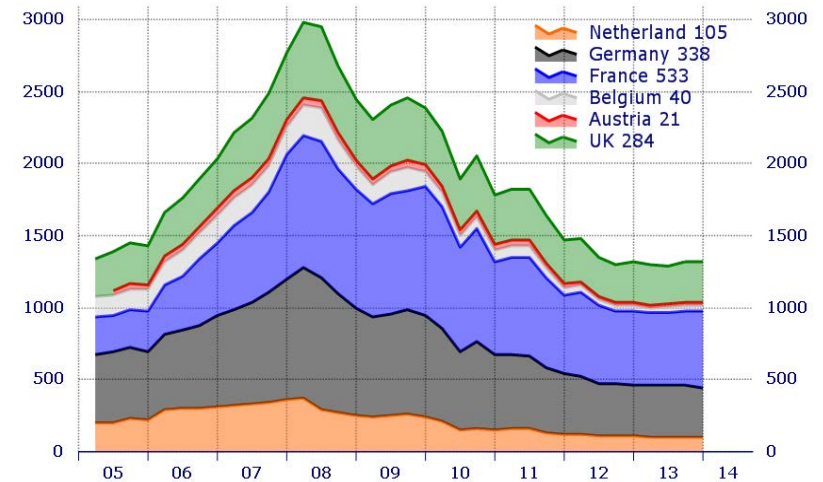


CREDIT INTEREST RATES
business credit under 1 mln euro

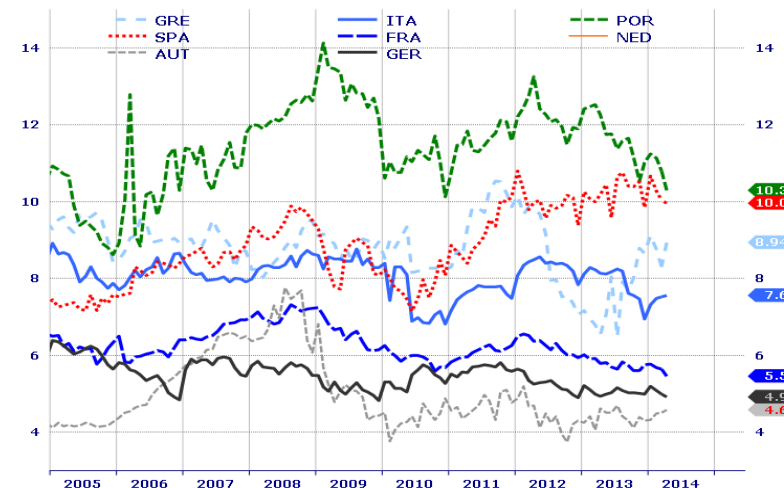


€ mld FOREIGN BANK'S ASSETS vs PERIPHERAL COUNTRIES

Aggregate banks data vs Italy, Eire, Greece, Spain, Portugal



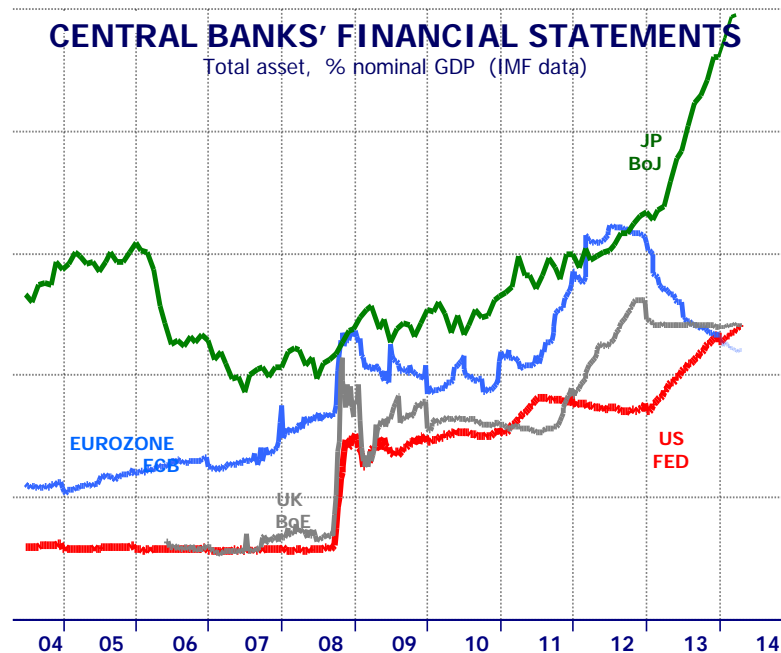
CREDIT INTEREST RATES
Consumer credit variable rate 1-5 years



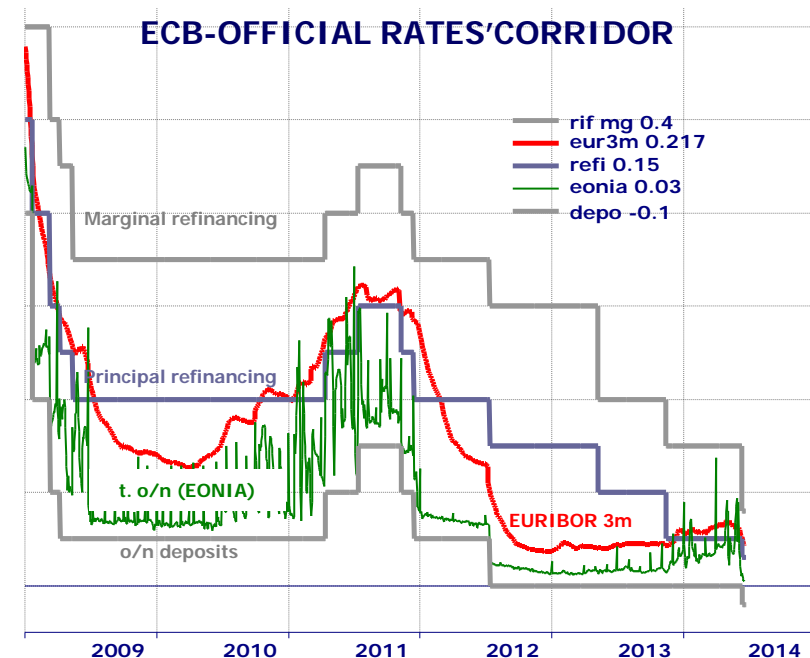
MONETARY POLICY AND FINANCIAL CONDITIONS

In the June meeting, ECB adopted a strongly expansive manoeuvre. It reduced the official rate to 0.15% from previous 0.25%, marginal refinancing rate at 0.4% from previous 0.75% and, finally, interest rate on Central Bank's deposits was lowered by 10 bp, making it negative for the first time, at -0.10%. It announced it shall interrupt liquidity sterilisation generated by the SMP programme, putting it in the system (165 bn). It has also proposed new long term loans (expiry 2018) from September and from December for banks, conditional on granting credit to the private sector. This mechanism may be renewed in 2015 and 2016 (expiry 2018), for a total amount that may be amply above 400 bn.

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MONETARY POLICY AND FINANCIAL CONDITIONS

The operations of principal refinancing with full adjudication shall be extended to 2016. Thus, soon a programme of purchase of asset backed securities (ABS) to favour alternative financial sources for the private sector.

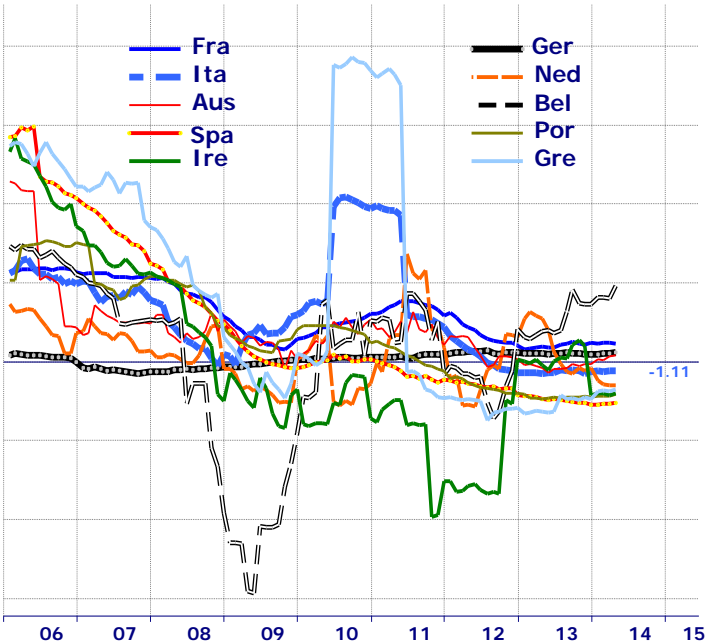
The package of measures has been coupled with a strengthening of “forward guidance”, announcing that rates will remain at current levels for a prolonged time period and, if necessary, there will be further unconventional measures. These strategies have been put in place to face the risks of a long period of low inflation, whose causes lie not only in downward pressure on food and energy prices, but also in the currency’s strength and in the fragility of internal demand.

After defining the first pillar of the Banking Union with the Single Supervisory Mechanism (bank surveillance under the ECB by November 2014, period necessary for the “Asset Quality Review” of the 130 banks and following “stress test”), the European Parliament has accepted, modified and approved the second pillar project proposed by Ecofin, which defines the regulatory mechanism for the unified management of banking crises. The basic framework is modified in a more federal sense and in terms of greater efficiency (sleeker and faster procedures): a bank’s failure will involve shareholders and creditors (up to 8% of the bank’s assets), with the creation of (a) a Resolution Committee that in an executive session and with a qualified weighted majority will take immediate decisions on appeal to single bank-saving fund (full session only for funds over 5 bln) and (b) a Resolution Fund, financed with private funds, i.e. the contributions on a national level for each bank...

BUSINESS LOANS- TREND

One year growth rates

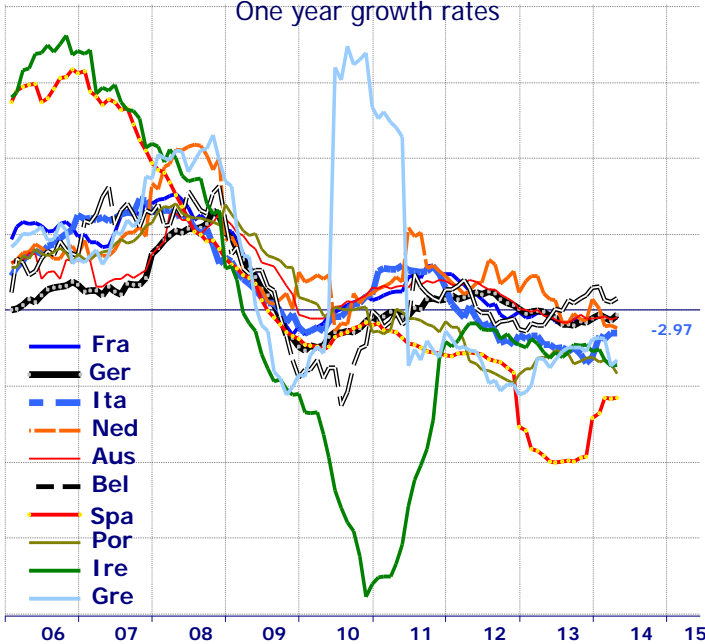
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HOUSEHOLDS' LOANS- TREND

One year growth rates

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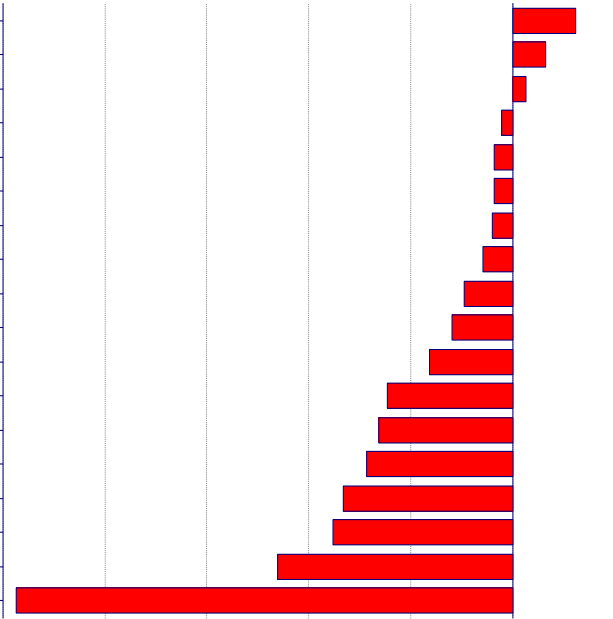


... The fund will work with national compartments, with 40% in common starting the first year and 70% in three years, with a final endowment (after eight years) of 55 bn euro. However, for the transition period, apart from the *bail-in* (that doesn't completely resolve the needs of coverage for restructuring), there's no financial structure that may break the perverse connection between government and banks. The new regulation foresees that the Resolution Committee must agree on financial solutions to obtain immediate liquidity, even from the public sector. Thus, there's something more than an option to seek support from a fund such as ESM. The Single Resolution Mechanism (SRM) will be in place from January 2015, while "bail in" will start in 2016.

BUSINESS LOANS

One year growth rates

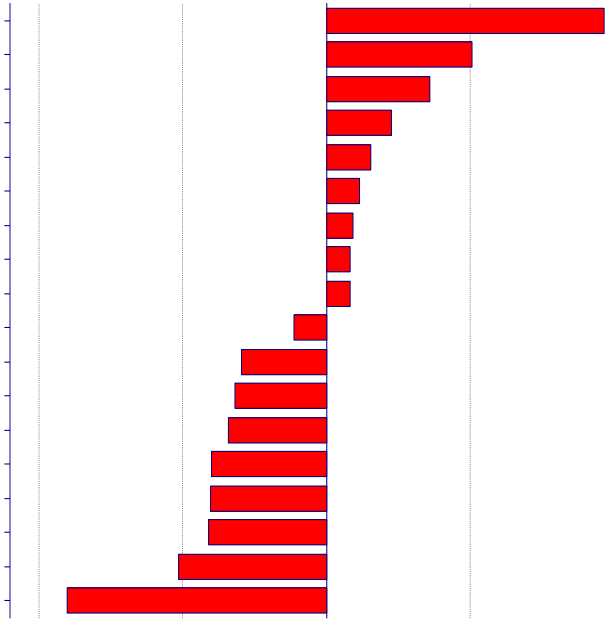




HOUSEHOLDS' LOANS

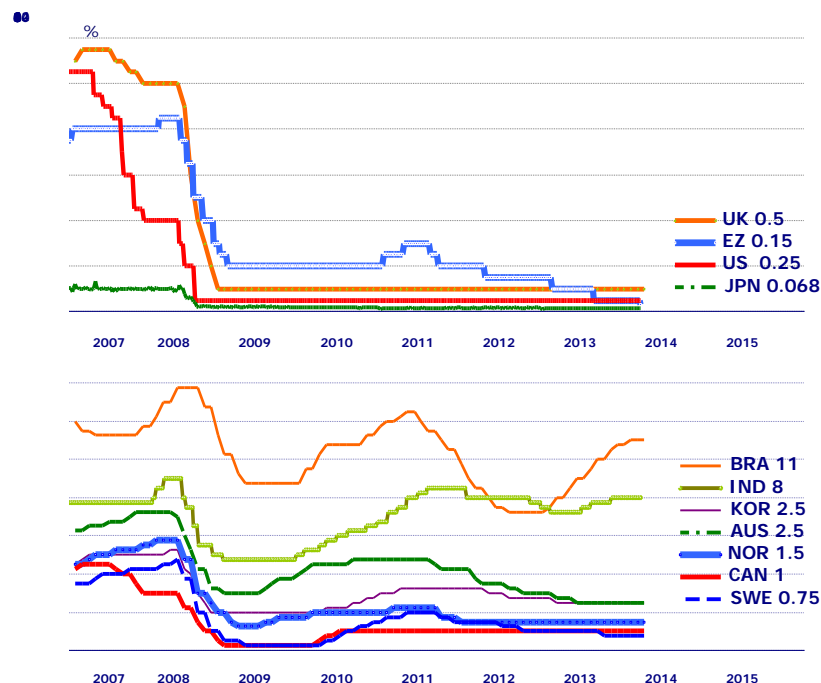
One year growth rates





In the June meeting, the Fed reduced by a further 10 bn USD its liquidity injections, bringing monthly asset acquisitions down to 35 bn (25 bn treasury bonds and 10 bn MBS). At the current pace, tapering will be over in Autumn, while the normalisation phase with increase in cost of money will start much later, by summer 2015. However, it has been stressed that the inversion in monetary policy will be gradual and with feasible targets. BoE confirmed stable QE (375 mln GBP) and forward guidance, i.e. if inflationary pressure is absent, before raising rates, the Committee for monetary policy will wait for further evidence of a reduction of excessive productive capacity. Among central banks, Mexico (at 3%) and Turkey (at 9.5%) have lowered rates between May and June by half a point. In April Russia raised them by the same value to 7.5% and New Zealand by 0.25% to 3%. The PBoC (China) reduced the rate of required reserves for rural credit twice. Overall, the system suffers from a significant drop in monetary and credit aggregates. Official rates are stable, while for the past weeks the exchange rate moved in the new fluctuation band (+/- 2% daily), suggesting weakness.

OFFICIAL REFERENCE RATES



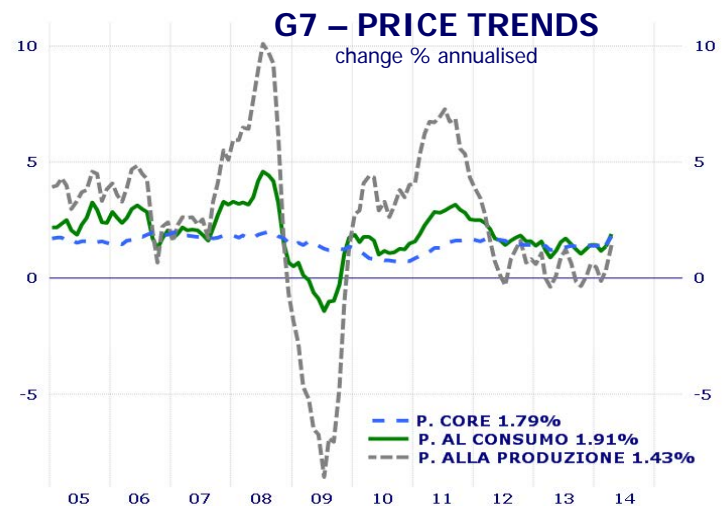
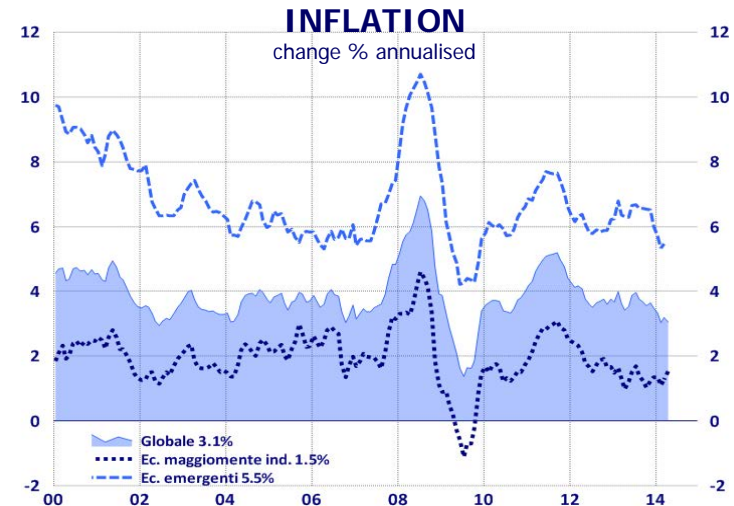
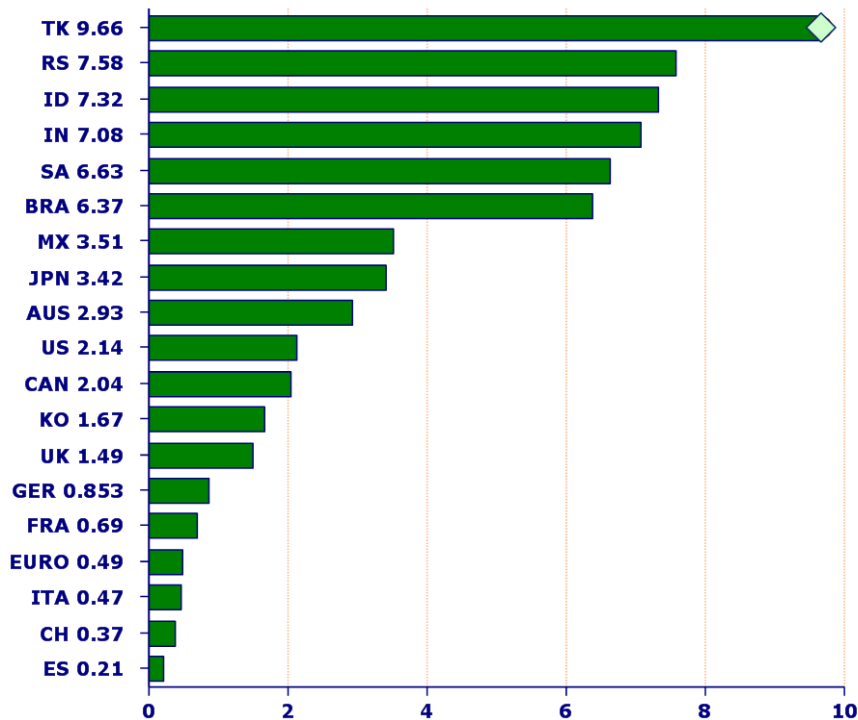
CHINA - RATES AND EXCHANGE RATES



INFLATION

Global inflation stopped the fall in April returning above 3%, thanks to the increase in the major economies (1.5%). Also the decrease of emerging markets halted, consolidating the 5.5% level. Among major economies, price trend is on the rise (April data), with an intensity unseen for the past two years: production prices are at +1.4%, the general price index is at 1.9% and core at 1.4% (impulses remain on the rise).

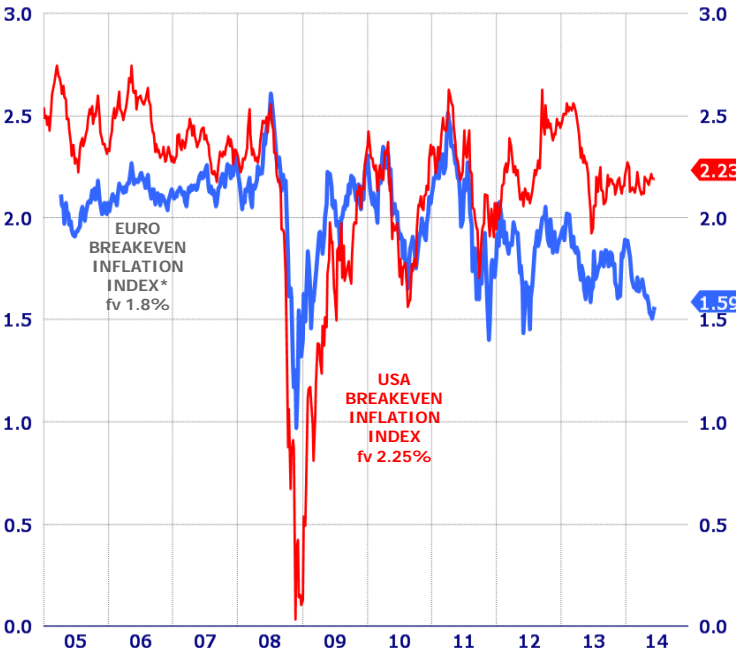
INFLATION BY COUNTRY
change % annualised – latest available data



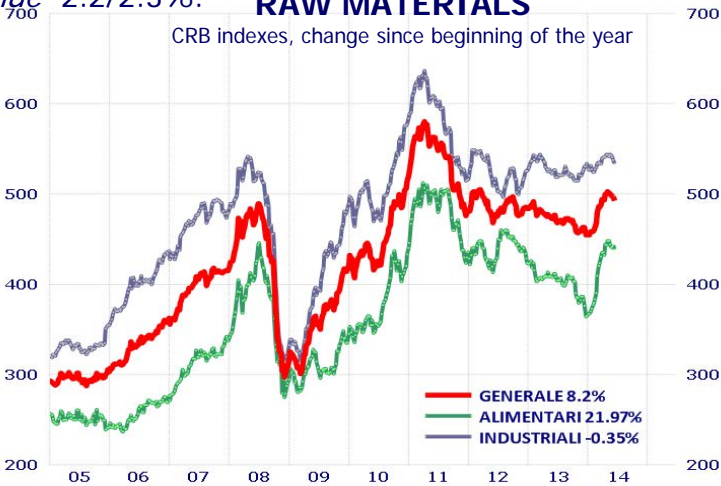
The general index of raw materials (CRB index) confirmed values around the 2012 highs, with a correction in June driven by decrease in food and industrial goods. The inflationary impulses observed are potentially able to drive price dynamics much higher. The 10 year European *linker* index (French stock) is under 1.5% at the lowest in this phase. We expect an evolution between 1.45% and 1.75% in the coming weeks. We indicate 2.1-1.6% as normal *range*, with a *fair value* at 1.8%. For the same in USD, we consider contrasting impulses in the 2.20% area, with a progressive predominance for the growing ones that should soon bring 2.25-2.30% in the normal area, 2.6-1.9% with *fair value* 2.2/2.3%.

EURO&USA 10y BREAKEVEN INFLATION

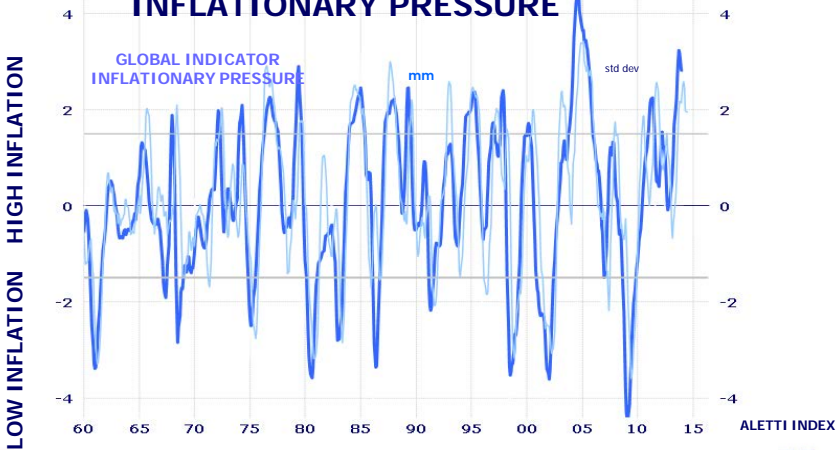
Euro index, based on French 1-15 y government bonds



RAW MATERIALS



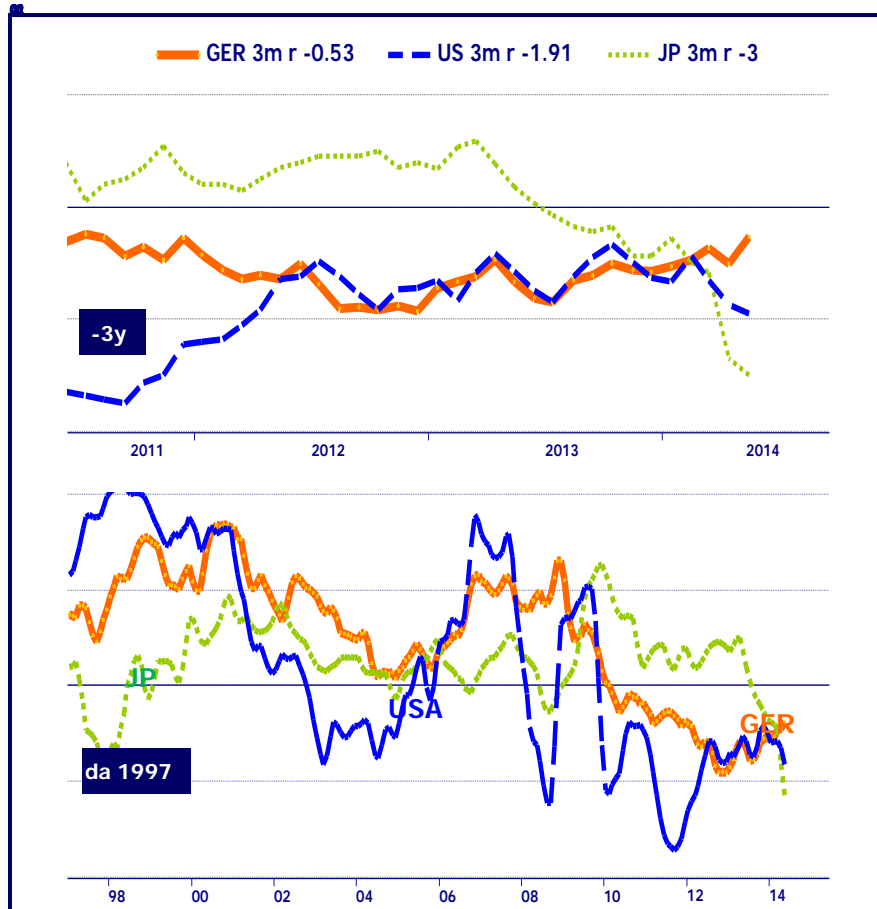
INFLATIONARY PRESSURE



Compared to compressed nominal rates, the real short term rates are negative in all three areas, mostly in Japan due to growth in inflation. Dynamic analysis indicates descending impulses in the coming weeks for USD and Yen, while for the euro the dynamic is forecasted to be stable/growing. Same with long term rates (those in USD are higher), thus the dominating force is downward, more for the Yen and for the USD.

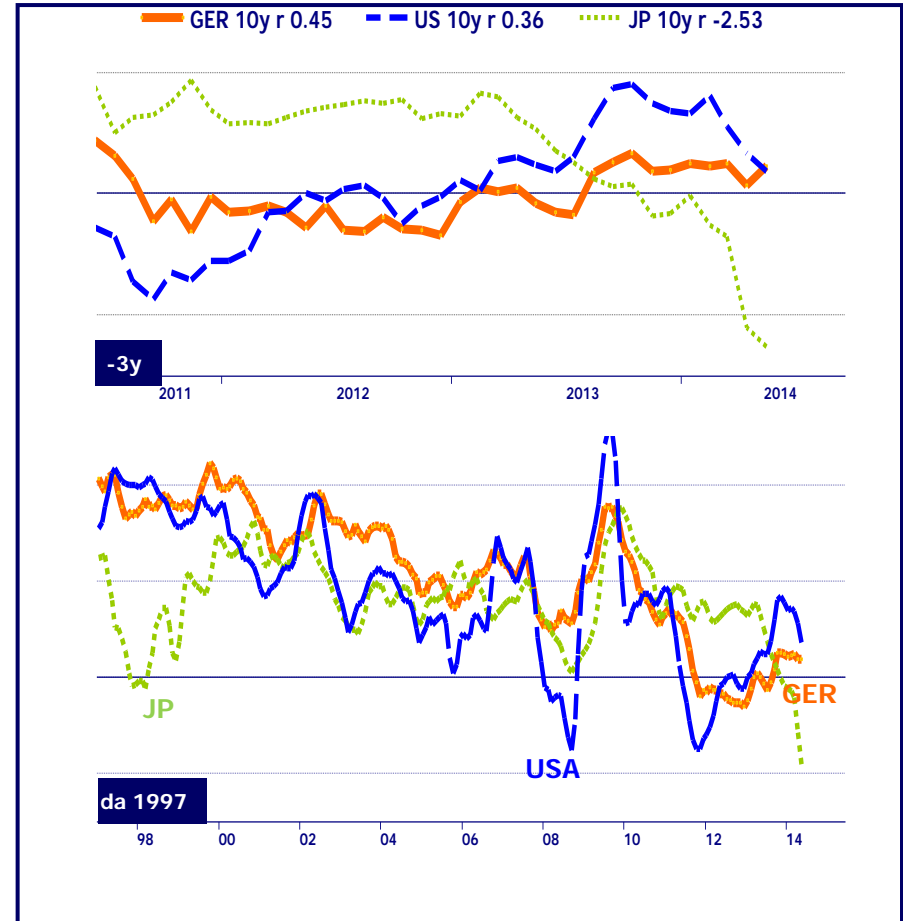
REAL 3 MONTH RATES

Deflated series with cpi – periods: -3y and from 1997



REAL TEN YEAR RATES

Deflated series with cpi – periods: -3y and from 1997

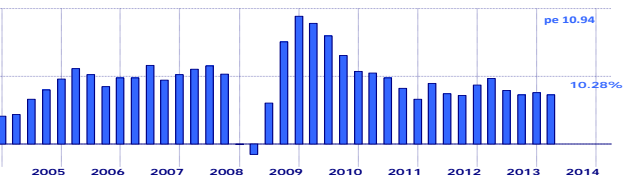
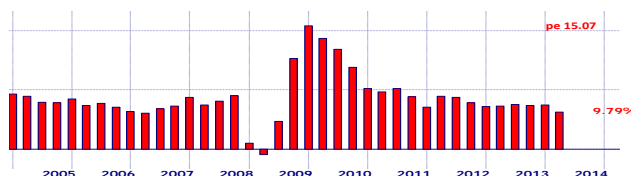


MSCI WORLD-MSCI G7- MSCI EMERGING MARKETS

Since March, the recovery trend among emerging markets and major markets is the main factor. The compartment has solid fundamentals and not unfavourable economic policies. Since the beginning of the year, the MSCI index of the seven major countries gains 5.6% while the MSCI EM. MARKETS has a 4.8% performance. The expected earnings growth in a year for the G7 is at 9.8% and 10.8% for EM.MKTS. MSCI G7 is at 15.11 times earnings, while MSCI EM.MKTS is at 10.94, decidedly relevant values in the first case, while in the second they leave room to grow. The condition, however, is not unstable, with a probable further expansion. The earning momentum is positive for the USA (on the rise) and Japan (decreasing). Eurozone and Far East are recovering, but not China.

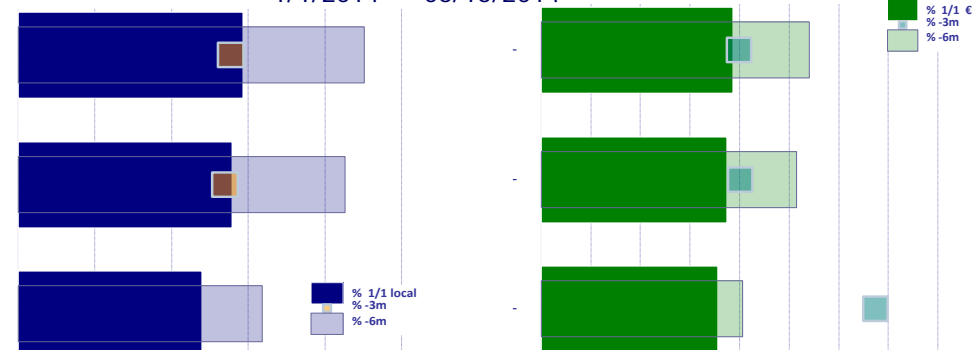
STOCK MARKET

Quarterly earnings and yearly trend

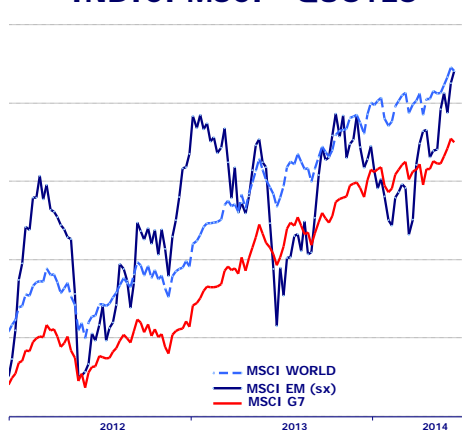


MSCI – performance in local currency and in euro

1/1/2014 - 06/16/2014



INDICI MSCI - QUOTES



PE RATIO FORWARD EARNINGS12M

Real values



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